

**EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED ON BEHALF OF
SURGERY CENTER OF SILVERDALE, LLC PROPOSING TO ESTABLISH AN AMBULATORY
SURGERY CENTER IN KITSAP COUNTY**

PROJECT DESCRIPTION

On March 3, 2005, Surgery Center of Silverdale, LLC was established as a limited liability company licensed in the state of Washington. On June 24, 2005, Surgery Center of Silverdale, LLC (SCS, LLC) submitted its Certificate of Need application to establish an ambulatory surgery center to serve the residents of Kitsap County, and surrounding areas. Within the March 3, 2005, LLC documents, SCS, LLC consisted of five physicians, each with at least 10% or greater membership interest in the LLC. [source: Initial Application, p5; Secretary of State website; and October 17, 2005, Business Risk Assessment provided by the Office of Financial Recovery]

On December 29, 2005, SCS, LLC submitted an application to amend its initial application that was submitted on June 24, 2005. Within the amended application, the membership of SCS, LLC was modified from the five-physician ownership described above to 70% Kitsap Outpatient Surgery, LLC¹ and 30% Harrison Medical Center, an acute care hospital located in the city of Bremerton, within Kitsap County. Below is a brief description of the owning entities of SCS, LLC. [source: Amended Application, pp5 & 10]

Surgery Center of Silverdale, LLC

Owning Entity	Percentage Owned
Kitsap Outpatient Surgery, LLC	70%
Harrison Medical Center	30%

Kitsap Outpatient Surgery, LLC -- 70% ownership of SCS, LLC

Owning Entity	Percentage Owned
Jason Cheun, MD	20%
Eric Cole, MD	20%
Todd Schneiderman, MD	20%
John Kerrigan, MD	20%
Blake Reiter, MD	20%

Harrison Medical Center, Bremerton -- 30% ownership of SCS, LLC

Harrison Medical Center (HMC), located in the city of Bremerton within Kitsap County, is currently a provider of Medicare and Medicaid acute care services to the residents of Kitsap County and surrounding communities, including portions of Jefferson, Mason, and Clallam counties. HMC currently operates 297 acute care beds on two campuses in Kitsap County: Bremerton Campus and Silverdale Campus. The Bremerton campus is located at 2520 Cherry Avenue in the city of Bremerton; and the Silverdale campus is located at 1800 Northwest Myhre Road in the city of Silverdale. HMC is also a Washington State level III trauma center and holds a three-year accreditation from the Joint Commission on Accreditation of Health Care Organizations. [source: CN historical files, Secretary of State website, and data obtained from the department's Office of Emergency Medical and & Trauma Systems]

¹ Kitsap Outpatient Surgery, LLC was established on December 8, 2005.

For this project, SCS, LLC proposes to establish a new ASC to be known as Surgery Center of Silverdale. The ASC would be located in the Clear Creek Professional Building at 9800 Levin Road, Suite 102, in the city of Silverdale, within Kitsap County. The ASC would have two operating rooms, pre- and post-operating space, procedure rooms and support/staff areas. If approved, services immediately offered at the ASC would be ophthalmology--including retinal, plastic, and pediatric--and general surgery. Once the facility becomes operational, SCS, LLC anticipates recruitment of specialists in ENT and podiatry. [source: Amended Application, pp6-8 & pp45-46]

If this project is approved, SCS, LLC anticipates commencement of the project immediately, and completion within twelve months. Under this timeline, the ASC would become operational in mid year 2007, and year 2008 would be the facility's first full calendar year of operation. [source: Amended Application, p17]

The estimated capital expenditure for this project is \$1,510,884, and of that amount, 69% is related to equipment (both fixed and moveable); 14% is related to fees; 11% is related to tenant improvements of the site; and the remaining 6% is related to startup and financing costs. [source: February 13, 2006, supplemental information, Appendix AAS-2]

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to Certificate of Need review as the establishment of a new health care facility under the provisions of Revised Code of Washington (RCW) 70.38.105(4)(a) and Washington Administrative Code (WAC) 246-310-020(1)(a).

APPLICATION CHRONOLOGY

March 3, 2005	Letter of Intent Submitted
June 24, 2005	Initial Application Submitted
June 25, 2005, through December 28, 2005	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses• 2nd screening activities and responses
December 29, 2005	Amendment Application Submitted
December 30, 2005 through February 26, 2006	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses• 2nd screening activities and responses
February 27, 2006	Department Begins Review of Application
April 19, 2006	Public Hearing Conducted/End of Public Comment
May 4, 2006	Rebuttal Documents Received at Department
June 19, 2006	Department's Anticipated Decision Date
July 19, 2006	Department's Revised Decision Date ²
July 7, 2006	Department's Actual Decision Date

² The department requested an extension to the decision date to July 19, 2006. The applicant concurred with the extension on June 26, 2006.

AFFECTED PERSONS

Throughout the review of this project, one entity--Olympic Ambulatory Surgery Center--sought and received affected person status under WAC 246-310-010. Olympic Ambulatory Surgery Center is a CN approved ASC located at 2613 Wheaton Way in the city of Bremerton, within Kitsap County.

SOURCE INFORMATION REVIEWED

- Surgery Center of Silverdale, LLC's Initial Certificate of Need Application received June 24, 2005
- Surgery Center of Silverdale, LLC's supplemental information dated September 29, 2005, and November 4, 2005
- Surgery Center of Silverdale, LLC's Amended Certificate of Need Application received December 29, 2005
- Surgery Center of Silverdale, LLC's supplemental information dated February 9, 2006 and February 15, 2006
- Public comment received throughout the review of the application
- Public hearing documents received at the April 19, 2006, public hearing
- Surgery Center of Silverdale, LLC's rebuttal comments received May 4, 2006
- Olympic Ambulatory Surgery Center's rebuttal comments received May 4, 2006
- Kitsap County ASC and/or operating room utilization survey responses
- Historical charity care data obtained from the Department of Health's Office of Hospital and Patient Data Systems (2002, 2003, and 2004 summaries)
- Population data obtained from the Office Financial Management based on year 2000 census published January 2002
- Licensing and/or survey data provided by the Department of Health's Office of Health Care Survey
- Business Risk Assessment provided by the Office of Financial Recovery dated October 17, 2005
- Comprehensive Hospital Abstract Reporting System (CHARS) data obtained from the Department of Health's Office of Hospital and Patient Data Systems
- Trauma designation data for Harrison Medical Center provided by the Department of Health's Office of Emergency Medical and Trauma Systems
- Data obtained from the Internet regarding mileage and distance
- Data obtained from the Internet regarding HealthSouth
- Certificate of Need Historical files

CRITERIA EVALUATION

To obtain Certificate of Need approval, the applicant must demonstrate compliance with the criteria found in WAC 246-310-210 (need); 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); 246-310-240 (cost containment) and WAC 246-310-270 (ambulatory surgery).³

³ Each criterion contains certain sub-criteria. The following sub-criteria are not relevant to this project: WAC 246-310-210(3), (4), (5), and (6).

CONCLUSION

For the reasons stated in this evaluation and agreement to the following terms, Surgery Center of Silverdale, LLC is approved to establish an ambulatory surgery center in the city of Silverdale within Kitsap County.

1. Before the ASC accepts patients for surgery, Surgery Center of Silverdale, LLC must provide the department with a copy of the final terms of debt financing with its funding source.
2. Within 120 days prior to completion of the project, Surgery Center of Silverdale, LLC must provide to the department for review and approval a copy of the final charity care policy for Surgery Center of Silverdale. The final charity care policy must be consistent with the draft policy provided in the application.

Provided that the applicant agrees to the terms outlined above, a Certificate of Need would be issued with the following condition.

Surgery Center of Silverdale, LLC will ensure that Surgery Center of Silverdale will provide charity care in compliance with the charity care policies provided in its Certificate of Need application and the requirements of the applicable law. Surgery Center of Silverdale will use reasonable efforts to provide charity care in an amount comparable to the average amount of charity care provided by Harrison Medical Center located in the applicant's proposed service area during the three most recent years. For historical years 2002-2004, these amounts are 1.34% of gross revenues and 3.35% of adjusted revenues. Surgery Center of Silverdale will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies and applicable law.

The approved capital expenditure associated with this project is \$1,510,884.

A. Need (WAC 246-310-210)

Based on the source information reviewed and subject to the terms and condition on page 4 of this evaluation, the department determines that the application is consistent with the applicable need criteria in WAC 246-310-210.

(1) The population served or to be served has need for the project and other services and facilities of the type proposed are not or will not be sufficiently available or accessible to meet that need

The Department of Health's Certificate of Need Program uses the numeric methodology found in WAC 246-310-270 for determining the need for additional ASCs in Washington State. The numeric methodology provides a basis of comparison of existing operating room (OR) capacity for both outpatient and inpatient OR's in a planning area using the current utilization of existing providers. The methodology separates Washington State into 54 separate secondary health services planning areas. The proposed ASC would be located in the Kitsap planning area.

The methodology estimates operating room (OR) need in a planning area using multi-steps as defined in WAC 246-310-270(9). This methodology relies on a variety of assumptions and initially determines existing capacity of dedicated outpatient and mixed-use operating rooms in the planning area, subtracts this capacity from the forecast number of surgeries to be expected in the planning area in the target year, and examines the difference to determine:

- a) whether a surplus or shortage of OR's is predicted to exist in the target year, and
- b) if a shortage of OR's is predicted, the shortage of dedicated outpatient and mixed-use rooms are calculated.

To determine need for additional ORs in the planning area under WAC 246-310-270, the applicant provided two separate estimates. The estimates are referenced in the application as Estimate #1-Baseline and Estimate #2-Adjusted from Baseline and summarized below. In the Estimate #1-Baseline, the applicant relied on the assumptions shown below.

Assumption	Data Used
Planning Area	Kitsap County
Population Estimates and Forecasts	Office of Financial Management's Kitsap County-medium series, published year 2002
Use Rate	Divide estimated current surgical cases by estimated 2005 populations results in the service area use rate of 92.4/1,000
Percent of surgery ambulatory vs. inpatient	Based on DOH survey results, 77.2% ambulatory setting; 22.8% inpatient setting
Average minutes per case	Outpatient cases = 50 minutes; inpatient cases 119.6 minutes (rounded to 120)
OR Annual capacity in minutes	68,850 outpatient surgery minutes; 94,250 inpatient or mixed-use surgery minutes
Existing providers	Based on DOH listing of Kitsap County providers

Under Estimate #1-Baseline, the applicant's methodology resulted in a projected surplus of four mixed-use ORs and a need for nine dedicated outpatient ORs for year 2010. [source: Amended Application, pp19-22]

In the Estimate #2-Adjusted from Baseline, SCS, LLC relied on many of the same assumptions as Estimate #1, with three exceptions--population estimates; use rate, and minutes per surgery.

Assumption	Data Used
Population Estimates and Forecasts	Office of Financial Management's Kitsap County-high series, published year 2002
Use Rate	Divide estimated current surgical cases by estimated 2005 populations results in the service area use rate; then increase the service area use rate by 5% to 97.0/1,000
Average minutes per case	Outpatient cases = 60 minutes; inpatient cases 119.6 minutes (rounded to 120)

Under Estimate #2, SCS LLC's methodology resulted in a projected surplus of two mixed-use ORs and a need for sixteen dedicated outpatient ORs for year 2010. [source: Amended Application, pp19-22]

In summary, using two separate estimates, the applicant applied the numeric methodology and concluded a need for additional outpatient ORs in the Kitsap planning area.

Given that the ASC would be located in Kitsap County, the department will apply the methodology to that health service planning area. There are seven providers in the Kitsap County planning area--one hospital and six ASCs. The seven providers are listed below. [source: CN historical files-FSL database]

Kitsap Planning Area Providers	
1 Hospital / City	6 ASCs / City
Harrison Medical Center / Bremerton & Silverdale campuses	Digestive Disease & Endoscopy Center, PLLC / Bremerton The Doctors Clinic / Silverdale North Kitsap ASC / Poulsbo Olympic ASC, Inc. / Bremerton Olympic Plastic Surgery Suite / Bremerton Pacific Cataract & Laser Institute / Silverdale

As shown above, the seven facilities include one hospital and six ASCs. Even though the hospital--HMC--is considered part of the applicant entity, its OR capacity will be used in the numeric methodology calculations under WAC 246-310-270.

Of the six ASCs shown above, four are located within a solo or group practice (considered an exempt ASC) and therefore, the use of these ASCs is restricted to physicians that are employees or members of the clinical practices that operate the facilities. Therefore, these four facilities do not meet the ASC definition found in WAC 246-310-010 and the ORs are not included in the capacity calculations of available ORs for the Kitsap planning area.

The two remaining ASCs-- North Kitsap ASC in Poulsbo and Olympia ASC, Inc. in Bremerton — are ASCs as defined in WAC 246-310-010 and the OR capacity of the two ASCs will be included in the capacity calculations of available ORs for the Kitsap planning area.⁴

To assist in its application of the numeric methodology for this project, in October 2005, the department requested utilization information from each of the facilities identified above.

⁴ North Kitsap ASC was issued CN #1124 on June 29, 1995; Olympic ASC was issued CN #0-490 on March 5, 1980.

Responses were received from six of the seven facilities.⁵ Further, the department relied on the following assumptions to apply its methodology.

Assumption	Data Used
Planning Area	Kitsap County
Population Estimates and Forecasts	Office of Financial Management's Kitsap County-medium series, published year 2002
Use Rate	Divide estimated current surgical cases by estimated 2005 populations results in the service area use rate of 90.43/1,000
Percent of surgery ambulatory vs. inpatient	Based on DOH survey results, 78.3% ambulatory setting; 21.6% inpatient setting
Average minutes per case	Based on DOH survey results, Outpatient cases = 47.5 minutes; inpatient cases 128.55 minutes
OR Annual capacity in minutes	68,850 outpatient surgery minutes; 94,250 inpatient or mixed-use surgery minutes
Existing providers	Based on DOH listing of Kitsap County providers

The department's application of the numeric methodology using survey responses indicates a surplus of 3 inpatient ORs and a need of 6 outpatient ORs for the Kitsap planning area in year 2010.

Olympic Ambulatory Surgery Center (OASC) provided concerns related to the methodology (WAC 246-310-270); the concerns are summarized below. [source: Olympic Ambulatory Surgery Center public hearing documents submitted April 19, 2006, pp2-17]

WAC 246-310-270

- Existing capacity is underrepresented by SCS in its amended application--a total of 24 ORs, rather than the 18, should be counted in the planning area,.
- The applicant's interpretation of the ASC modified need methodology is inherently flawed.
- The applicant's use of the high series population projections in the modified need methodology to determine future demand is unsupported and unwarranted.
- SCS's use of an increased use rate in the modified need methodology is speculative and unsubstantiated.
- SCS's use of inflated average minutes per surgery in the modified need methodology is unsupported and unnecessary.
- SCS erroneously argues that mixed-use rooms are not interchangeable and available to support both inpatient and outpatient surgeries.
- SCS's assertion of increasing demand for outpatient services based on "trend analysis" is unsupported and unreasonable.

Given that the department did not adopt SCS, LLC's modified need methodology and relied on the assumption outlined above to apply its own methodology under WAC 246-310-270, and relied on those results within this evaluation, OASC's concerns outlined above have been addressed.

⁵ The Doctor's Clinic in Silverdale did not submit a response to the utilization survey.

In summary, based solely on the numeric methodology contained in WAC 246-310-270, need for additional outpatient OR capacity in the Kitsap planning area is indicated. [source: department's methodology and utilization surveys]

To further demonstrate compliance with this criterion, the applicant provided the following information. [source: Amended Application: pp25-29]

“Need for services based on DOH standards

...Assuming the DOH standards reflect needed capacity to support availability and accessibility, this indicates that the proposed project does not constitute an unnecessary duplication of services for dedicated outpatient surgery.

Lack of surgeons’ access to operating rooms

One SCS member elected recently to re-locate his surgery procedures from the free-standing ASC he had been using. He was unable to get a commitment of OR time from the hospital and but was able to get a short-term commitment of a time slot at a free-standing ASC located in Bremerton through the end of the year. While this Bremerton site is inconvenient for him and his patients, it was the only available alternative for committed block time.

Shortages of specialty physicians and services in Kitsap County

...HMC indicates that nearly 30% of Kitsap County residents are leaving the county for their inpatient care. This is supported by 2004 market share data from CHARS. New directions at HMC will result in improved facilities and targeted recruiting . As it firms up its long-range planning, HMC will continue investing in its cardiac surgery program and other specialties under-represented on the HMC medical staff. All of these efforts will put even more pressure on inpatient surgical capacity than that experienced in 2005. Availability of ambulatory surgical capacity that is convenient for physicians and patients will be even more restricted.”

OASC provided concerns related to the need criterion (WAC 246-310-210) which are summarized below. [source: Olympic Ambulatory Surgery Center public hearing documents submitted April 19, 2006, pp2-17]

WAC 246-310-210

- The community has sufficient access to the proposed health care services.
- Existing facilities are not being used efficiently or appropriately.
- Adding an additional ASC facility to Kitsap County would negatively impact existing facilities.

Within its rebuttal documents, SCS, LLC provided the responses to the concerns raised above. [source: SSC, LLC rebuttal documents, pp27-47]

To evaluate OASC’s concerns, the department reviewed the historical utilization data provided by OASC within its survey responses. The survey covers full years 2002 through 2004 and indicates that OASC houses a total of four ORs; of the four ORs, two are dedicated outpatient and two closed or not in use. Using the year 2004 number of surgical minutes in year 2004, OASC was operating at 61% of its four OR capacity. Additional notes provided in the OASC survey responses state that the opening of another exempt ASC facility in the county has resulted in a loss of 50% of OASC’s business, resulting in OASC operating at 28% of capacity on a monthly basis. OASC further states that approval of the SCS, LLC project would result in a loss of five OASC

surgeons, resulting in a potential drop in utilization at OASC to 15% of capacity. OASC asserts that its ORs are available and accessible to the physicians and it has the capacity to accommodate additional surgeries.

To further evaluate OASC's concerns, the department reviewed OASC's historical facility files. On March 5, 1980, Department of Social and Health Services 1122 #0-489 and #0-490 were issued to OASC approving the establishment of an ASC in Bremerton. Documentation provided in the approval indicates that at the time of its establishment, OASC was not affiliated with HealthSouth. OASC became operational on April 18, 1983. On September 26, 1991, historical documentation reveals that OASC was purchased by an entity known as Kitsap Peninsula Surgery Center, which was an affiliate of National Surgery Centers.⁶ The department's historical records for OASC are sketchy from years 1992 through 1997, however, on April 28, 1998, OASC requested a determination of non-reviewability related to the relocation of OASC from Cherry Avenue to Wheaton Way, both in Bremerton. Within that request, OASC states that it operates three ORs, with 72 physicians that perform approximately 350-400 cases per month. Based on this data, the department calculated OASC's capacity for year 1998 to be 88% utilization of three ORs.⁷ The April 1998 request from OASC does not indicate an affiliation with HealthSouth. Historical files also reveal that OASC expanded its OR capacity in 1990. In year 2000, OASC relocated the ASC based on its 1998 determination of non-reviewability. A September 18, 2000, letter from OASC is provided on company letterhead with the following notation: OLYMPIC AMBULATORY SURGERY CENTER, HEALTHSOUTH. None of the historical files related to OASC provide the exact date of OASC's affiliation with HealthSouth, however, historical files confirm the relationship has existed since at least September 2000 and continues to exist as of the writing of this evaluation. [source: OASC CN and OHCS facility files and FSL data base]

As of the writing of this evaluation, OASC continues to be part of the HealthSouth organization. As of December 2005, HealthSouth is one of the largest healthcare service providers, with locations in the United States, Puerto Rico, and Australia. Beginning in late 2002 and early 2003, HealthSouth learned of a broad governmental investigation related to its financial reporting practices prior to March 2003. Related to this investigation, HealthSouth states *"over the past three years, we have focused substantial time and attention responding to various legal, financial, and operational challenges resulting from the financial fraud perpetrated by certain members of our prior management team. This fraud was uncovered as a result of a series of governmental investigations into our public reporting and related matters, which we became aware of in late 2002 and early 2003. In connection with these investigations, on March 19, 2003, the United States Securities and Exchange Commission filed a lawsuit against us and our then Chairman and CEO...alleging among other things that we overstated earnings by at least \$1.4 billion since 1999."*

According to financial data obtained through the United States Securities and Exchange Commission for years 2003, 2004, and 2005, public disclosure of the investigations and the lawsuit precipitated a number of events that had an immediate and substantial negative impact on HealthSouth's business, financial condition, results of operations, and cash flows. One of those events includes HealthSouth's sale of its healthcare services and downsizing staff. This conclusion

⁶ National Surgery Centers, Inc. operates freestanding ambulatory surgery centers in the United States.

⁷ 38 minutes per case (per survey) multiplied by 400 cases is 15,200/month. 15,200 multiplied by 12 is 182,400/annual minutes. 3 ORs multiplied by 68,850 is 206,550. 182,400 divided by 206,550 is .8830 or 88% utilization of 3 ORs.

is evident when comparing years 2004 and 2005 data.⁸ HealthSouth also indicates that most of its ASCs are owned by partnerships which include physician partners who perform surgical procedures at the centers. [source: United States Securities and Exchange Commission for years 2003, 2004, and 2005]

Within its 2005 financial statement, HealthSouth provides the following statements. [source: United States Securities and Exchange Commission, year 2005, page numbers where noted]

“We are highly leveraged. As a consequence, a substantial down-turn in earning could jeopardize our ability to make our interest payment and could impair our ability to obtain additional financing, if necessary. Current and prospective investors, patients, physician partners, and employees may react adversely to the continuing negative effects of the March 2003 crisis and the financial reporting and operational issues that were uncovered as a result of that crisis.” [pp38 & 40]

As stated above, HealthSouth acknowledges that the March 2003 financial reporting and operational issues may impact its ability to recruit and retain physicians, investors, patients, and employees. This appears to be occurring in Kitsap County, whereby Kitsap County physicians are unwilling to align with the HealthSouth organization. [source: SCS, LLC May 4, 2006, rebuttal documents, pp61-62] This is evidenced by data provided in the application and HealthSouth’s acknowledgement of difficulties with recruitment and retention efforts.

OASC further asserts that approval of the SCS, LLC project could result in a loss of five OASC surgeons. Within the application, SCS, LLC identified one physician that is utilizing OASC for surgeries.⁹ The remaining physicians are using one of the HMC sites or have been recruited from out-of-state. As a result, OASC’s assertion is not substantiated within the documents provided in the application.

Based on the information within the application and data reviewed, the department concludes that approval of this project is reasonable, this sub-criterion is met.

- (2) All residents of the service area, including low-income persons, racial and ethnic minorities, women, handicapped persons, and other underserved groups and the elderly are likely to have adequate access to the proposed health service or services.

As stated in the project description portion of this evaluation, SCS, LLC was established for the purpose of owning and operating the ASC related to this project. HMC currently owns or operates a variety of health care facilities in Washington State. Through these health care facilities, HMC has historically provided health care services to residents of Kitsap County and surrounding area including low-income, racial and ethnic minorities, handicapped and other underserved groups.

To demonstrate compliance with this sub-criterion, SCS, LLC provided a copy of the admission policy intended to be used for the ASC. The policy indicates that patients are admitted to the proposed ASC without regard to age, race, color, religion, sex, national origin, handicap, or sexual preference and will be treated with respect and dignity. [source: September 29, 2005, supplemental information within initial application, Appendix SC-9]

⁸ For example, in 2004, HealthSouth indicates that it has 1,300 facilities and approximately 40,000 full-and part-time employees, compared with 2005 data which identifies 1,070 facilities and 37,000 employees. Related to its ASCs, in year 2004, HealthSouth provided services through 177 freestanding ASCs in 36 states; however, by December 2005, the number of ASCs decreased to 158 in 35 states.

⁹ Eric Cole, MD

To determine whether low income residents would have access to the ASC, the department uses the facility's Medicaid eligibility or contracting with Medicaid as the measure to make that determination. Information provided by the applicant verifies that the ASC would contract with Medicaid. Further, within the application, SCS, LLC provided its sources of revenues at the ASC, which identifies 6% Medicaid. [source: Amended Application, p16]

WAC 246-310-270(7) states that ASCs shall implement policies to provide access to individuals unable to pay consistent with charity care levels reported by the hospitals affected by the proposed ASC. For charity care reporting purposes, the Department of Health's Office of Hospital and Patient Data Systems (OHPDS), divides Washington State into five regions: King County, Puget Sound (less King County), Southwest, Central, and Eastern. SCS, LLC's ASC would be located in Kitsap County within the Puget Sound region. For charity care reporting purposes, the affected hospital includes HMC, one of the owning entities of SCS, LLC. For this project, the department reviewed charity care data for HMC and the 18 existing hospitals currently operating within the Puget Sound Region.

According to 2003-2004¹⁰ charity care data obtained from OHPDS, the three-year average for the Puget Sound Region is 1.28% for gross revenue and 2.62% for adjusted revenue. The three-year charity care data reported by HMC is 1.34% of gross revenue and 3.35% of adjusted revenue. [source: OHPDS 2002-2004 charity care summaries]

The applicant's pro formas indicate that the ASC will provide charity care at approximately 2% of gross revenue, and 2.4% of adjusted revenue. [source: February 13, 2006, supplemental information, Appendix AAS-2] These averages are comparable to the average charity care provided in the Puget Sound Region, and better than the average provided by HMC for its gross revenues. Given that the amount of charity care proposed to be provided at SCS, LLC's ASC is comparable to the three-year historical gross revenue averages for the region and HMC, yet less than the three year average for adjusted revenues, if this project is approved, the department concludes that a condition related to the charity care to be provided at the ASC would be necessary.

The department concludes that any approval of this project must be conditional upon the proposed ASC providing charity care at the level outlined above. With this condition, this sub-criterion is met.

B. Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed and subject to the terms and condition on page 4 of this evaluation, the department determines that the application is consistent with the applicable financial feasibility criteria in WAC 246-310-220.

(1) The immediate and long-range capital and operating costs of the project can be met.

To determine whether SCS would meet its immediate and long range operating costs, the department reviewed the projected balance sheets for the first three full years of operation--years 2008--2010. A summary of the balance sheets provided by the applicant is shown in Table I on the following page. [source: February 13, 2006, supplemental information, Appendix SSA-2]

¹⁰ Year 2005 charity care data is not available as of the writing of this evaluation.

Tables I
SCS Projected Balance Sheets for Years 2008-2010

Year 2008

Assets		Liabilities	
Current Assets	\$ 764,263	Current Liabilities	\$ 46,418
Other Assets	1,330,674	Other Liabilities (long term debt)	979,927
Total Assets	\$ 2,094,937	Total Liabilities	\$ 1,026,345
		Equity	1,068,591
		Total Liabilities and Equity	\$ 2,094,937

Year 2009

Assets		Liabilities	
Current Assets	\$ 845,936	Current Liabilities	\$ 52,871
Other Assets	1,060,637	Other Liabilities (long term debt)	889,232
Total Assets	\$ 1,906,573	Total Liabilities	\$ 942,103
		Equity	964,469
		Total Liabilities and Equity	\$ 1,906,573

Year 2010

Assets		Liabilities	
Current Assets	\$ 890,749	Current Liabilities	\$ 55,533
Other Assets	790,601	Other Liabilities (long term debt)	791,983
Total Assets	\$ 1,681,350	Total Liabilities	\$ 847,513
		Equity	833,834
		Total Liabilities and Equity	\$ 1,681,350

Based on the projected balance sheets shown above, it is clear that the ASC would be financially stable. Further, a review of the balance sheets provided in the application, indicates that the ASC intends to acquire very little long term debt for this project, and pay off its debt fairly quickly. While this approach by the applicant is ambitious, it is not an unusual approach for an ASC.

Comments provided by Olympic Ambulatory Surgery Center related to the financial feasibility criteria focused on four issues, which are restated below.

- SCS represents unreasonable capital costs because it underestimates the costs required to construct the project's facility;
- SCS represents unrealistic operating costs related to salary structure;
- Financial stability of the proposed project presets significant risk; and
- SCS's projection of utilization is based on development of physician practices.

[source: Olympic Ambulatory Surgery Center public hearing documents, submitted April 19, 2006, pp18-19]

The four issues raised by Olympic Ambulatory Surgery Center were addressed by SCS, LLC within its rebuttal documents. [source: SCS, LLC May 4, 2006, rebuttal documents, pp48-53] Below is a summary of the SCS, LLC responses.

- OASC reviewed the projected costs for the initial application, rather than those identified in the amended application. The capital costs in the amended application are reflected of the costs required to construct the ASC.

- OASC incorrectly analyzed the staffing model as the number of individual employees, rather than as a budget of FTEs. For example, with 3.5 RN FTE's planned, including 1.25 RN FTEs in PACU alone, the ASC may have as many as 6-10 different employees filling those roles through a combination of full-time, part-time, and per diem nursing staff. The ability to release staff when cases are complete leaves more staffing hours for time when needed.
- SCS, LLC provided a summary of its current success with recruitment of surgeons since the submission of the initial application in year 2005. Further, since May 2006, HMC alone has recruited 30 new physicians.

The department concludes that the four issues raised by OASC were adequately addressed by SCS. Based on the financial information above, the department concludes that the long-term capital and operating costs of this project can be met, and this sub-criterion is satisfied.

(2) The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.

If this project is approved, SCS, LLC anticipates commencement of the project immediately, and completion within twelve months. Under this timeline, the ASC would become operational in mid year 2007, and year 2008 would be the facility's first full calendar year of operation. [source: Amended Application, p17] Using this timeline, Table II below details the projected revenues and expenses for the ASC for partial year 2007 and full years 2008-2010. [source: February 13, 2006, supplemental information, Appendix AAS-2]

Table II
Surgery Center of Silverdale ASC Revenue and Expense Summary

	Partial Year 2007	Full Year 1 2008	Full Year 2 2009	Full Year 3 2010
Number of Surgeries	1,467	2,241	2,527	2,719
Net Revenue*	\$ 855,016	\$ 2,029,496	\$ 2,309,255	\$ 2,434,859
Total Expense	\$ 985,151	\$ 1,685,124	\$ 1,874,134	\$ 1,982,742
Net Profit or (Loss)	(\$ 130,135)	\$ 344,372	\$ 435,121	\$ 452,117
Net Revenue per Surgery	\$ 582.83	\$ 905.62	\$ 913.83	\$ 895.50
Total Expenses per Surgery	\$ 671.54	\$ 751.95	\$ 741.64	\$ 729.22
Net Profit or (Loss) per Surgery	(\$ 88.71)	\$ 153.67	\$ 172.19	\$ 166.28

*Includes deductions for charity care; no deductions for bad debt or contractual allowances

As shown in Table II above, partial year 2007 results in a net loss for the ASC, and a net profit in each of the facility's first three full years of operation. As stated in the project description portion of this evaluation, initially, the ASC would be providing surgeries related to ophthalmology and general surgery. Once the ASC is operational, the applicant anticipates recruitment of specialists in ENT and podiatry. The additional physicians are David Spinak, MD; Ty Chun, MD, and Gerald Fleischhauer, MD. The proposed number of surgeries shown in Table II above reflects these additional physicians.

In addition to the pro forma projections provided above, SCS, LLC also provided the following statements related to the assumptions used as a basis for the projections at the ASC. [source: Amended Application, pp44-45]

“SCS's projected 5-10% growth in individual existing practices [of Drs.] Schneiderman, Cheung, Cole, Chun, & Fleischhauer is driven by two factors--the first is market dynamics

and the second is individual practice dynamics. [emphasis added] Market dynamics include...population growth, aging, cultural trends toward demand for more cosmetic surgery, the trend toward more reliance on the local medical community, increasing use of outpatient settings for surgery due to improved anesthesiology and changing surgical technologies including less-invasive procedures; shortages of surgeons which will be addressed through the market's response to demand exceeding supply. ...Practice dynamics include the internal growth of surgical practices. Of the four existing surgeons, three practices are still considered "immature" due to the young age of the physicians and the relatively short period they have been in practice in Kitsap County. The growth in these practices has not yet reached a plateau and they are experiencing steady annual growth."

Documents provided in the application, support the applicant's assertions regarding market and individual practice dynamics. Further, the projected percentages of increase (5%-10%) based on the assertions is not considered to be a substantial increase when applied to the small number of cases projected in the application.

CN program staff also compared the projected costs and charges above to those of recent ASC applications. That comparison reveals that the costs and charges identified above are comparable to those shown in like-type ASC applications.

Based on the information provided above, the department concludes that the cost of the project will not result in an unreasonable impact on the costs and charges for health services within the service area. This sub-criterion is met.

(3) The project can be appropriately financed.

As stated in the project description portion of this evaluation, the estimated capital expenditure for this project is \$1,510,884, and of that amount, 69% is related to equipment (both fixed and moveable); 14% is related to fees; 11% is related to tenant improvements of the site; and the remaining 6% is related to startup and financing costs. [source: February 13, 2006, supplemental information, Appendix AAS-2]

SCS, LLC proposes to finance the project through two sources--partner contributions (15% of total) and debt financing through a local lending institution (85% of total). Further, the LLC intends to establish an operating line of credit through the same lending institution to ensure costs are met for opening year 2007. A breakdown of the contributions, financing, and line of credit is shown below.

Partner Equity Investment	\$ 226,633
Bank Financing 7% for ten years	<u>\$ 1,284,252</u>
Total Capital Expenditure	\$ 1,510,885

Plus Year 2007 Operating Line of Credit	<u>\$ 150,000</u>
Total Funding Obligations by Source	\$ 1,660,885

To demonstrate that the funding and line of credit is available for this project, SCS, LLC provided the following documentation:

- accredited investor information for each of the five investing physicians;
- historical financial data for HMC; and

- a letter from Marine Bank in Kingston confirming a commitment to financing and an operating line of credit for the ASC.

[source: September 29, 2005, supplemental information, Appendix SC-11; November 4, 2005, supplemental information, Appendix SC2-3 & SC2-8; February 13, 2006, supplemental information, Appendix AAS-2]

For the partner Equity Investment shown above, HMC and the physicians have already contributed their respective shares--HMC at \$180,000; and the five physicians totaling \$46,633. Further, if funds are available, equipment will be purchased, rather than leased because of the high costs associated with lease rates. [source: Amended Application, p42]

To ensure that the funds to be debt financed will be available and the project would remain financially viable, approval of this project would be based on SCS, LLC's agreement to the following term:

- Before the ASC accepts patients for surgery, Surgery Center of Silverdale, LLC must provide the department with a copy of the final terms of debt financing with its funding source.

Based on the above evaluation and with SCS, LLC's agreement to the term above, the department concludes that the proposed financing is appropriate. This sub-criterion is met.

C. Structure and Process (Quality) of Care (WAC 246-310-230)

Based on the source information reviewed and subject to the terms and condition on page 4 of this evaluation, the department determines that the application is consistent with the applicable structure and process of care criteria in WAC 246-310-230.

(1) A sufficient supply of qualified staff for the project, including both health personnel and management personnel, are available or can be recruited.

As stated in the project description portion of this evaluation, SCS, LLC anticipates commencement of the project immediately, and completion within twelve months. Under this timeline, the ASC would become operational in mid year 2007, and year 2008 would be the facility's first full calendar year of operation. [source: Amended Application, p17] SCS, LLC anticipates recruiting 7.25 FTEs when the ASC becomes operational, and a minimal increase in FTEs through year 2010. Table III below summarizes the projected staffing of SCS. [source: September 29, 2005, supplemental information, Appendix S-10]

Table III
Surgery Center of Silverdale Projected Staffing

Projected Staffing	2007 Initial	2008 Increase	2009 Increase	2010 Increase	Total FTEs
Business Office Manager	1.00	0.00	0.00	0.00	1.00
RN/MBA	1.00	0.00	0.00	0.00	1.00
RN/OR	1.25	0.00	0.25	0.25	1.75
OR Tech Management	1.25	0.25	0.00	0.25	1.75
X-Ray Tech	0.00	0.00	0.00	0.25	0.25
RN/PACU	1.25	0.25	0.00	0.25	1.75
Scheduling/Clerical	0.50	0.25	0.25	0.00	1.25
Records/Clerical	0.25	0.25	0.00	0.25	0.75
Billing/Bookkeeper	0.75	0.25	0.25	0.00	1.25
Total FTEs	7.25	1.25	0.75	1.25	10.50

To further demonstrate that staff for the ASC either would be available or can be recruited, SCS, LLC provided the following statements:

“A large number of health care professionals who live in Kitsap County currently commute to Tacoma or the Seattle area for employment. Recruitment of nurses and other personnel will not be a problem because many of these professionals prefer employment that does not involve such a long commute. Additionally, the work environment of a small outpatient surgical facility that does not require evening or weekend call of its staff offers a strong recruiting plus for its team. The small scale of the organization and generally a more inclusive work environment also enhance an ASC’s ability to attract and retain staff.”

[source: Amended Application, p48]

Comments provided by Olympic Ambulatory Surgery Center related to the structure and process (quality) of care criteria focused on four issues, which are restated below.

- A sufficient supply of qualified staff for the project is not immediately available and is difficult to recruit;
- SCS asserts a need for surgical specialists, but misrepresents the existing supply of such specialists in Kitsap County;
- The proposed project will not have an appropriate relationship to the existing health care system in Kitsap County;
- The proposed project may not be in compliance with applicable laws regarding anti-trust laws.

The four issues raised by OASC were addressed by SCS, LLC within its rebuttal documents. [source: SCS, LLC May 4, 2006, rebuttal documents, pp54-60] Below is a summary of the SCS, LLC responses.

- As previously stated, SCS, LLC provided a summary of its current success with recruitment of surgeons, as well as HMC’s success with recruitments. It is likely that HealthSouth’s lack of success with recruitment and retention of surgeons for OASC would not be experienced by SCS, LLC for its ASC.
- OASC asserts that the proposed ASC’s location of less than one mile from HMC is duplication of services, however, health planners in Kitsap County are facing the inevitable growth in the Silverdale area. Establishing an ASC in Silverdale that is associated with HMC assists the hospital in reaching its goals of responding to growing and continued need for services in the county.
- OASC submits this concern based on its own documented practices, wherein HealthSouth states, *“...Because we invest in each partnership that owns an ASC and often provide management and other services to the ASC, our arrangements with physician investors do not fit within the terms of the ASC Safe Harbors. ...we cannot ensure that all physician-investors will perform, or have performed, 1/3 of their procedures at the ASC or have informed or will inform their referred patients of their investment interests. ...there can be no assurance that the ownership interests in some of our ASCs will not be challenged under the Anti-Kickback Law.”*

SCS, LLC does not intend to operate its ASC outside of all federal and state laws and regulations as they apply to ASCs and physician ownership.

The department concludes that the four issues raised by OASC were adequately addressed by SCS. Based on the structure and process of care information provided in the application, the department

concludes that the long-term capital and operating costs of this project can be met, and this sub-criterion is satisfied.

Based on the information provided in the application, the department concludes that the applicant provided a comprehensive approach to recruit and retain staff necessary for the ASC. This sub-criterion is met.

- (2) The proposed service(s) will have an appropriate relationship, including organizational relationship, to ancillary and support services, and ancillary and support services will be sufficient to support any health services included in the proposed project.

To demonstrate compliance with this sub-criterion, the applicant provided copies of the following documents/service contracts and/or agreements. [sources: where noted]

- Draft Charity Care Policy for SCS, LLC [Initial Application, Appendix I]
- Medical Director Job Description signed by proposed medical director--Blake Reiter, MD--and SCS, LLC [September 29, 2005, supplemental information, Appendix 1]
- Admission Policy for SCS, LLC [September 29, 2005, supplemental information, Appendix 9]
- Agreement between Reitinger & Associates, Inc. and SCS, LLC for interim management services [November 4, 2005, supplemental information, Attachment SC2-1]
- Patient Transfer Agreement between SCS, LLC and Harrison Medical Center [November 4, 2005, supplemental information, Attachment SC2-4]
- Operating Agreement between Kitsap Outpatient Surgery and Harrison Medical Center for the operations of the ASC [Amended Application, Exhibit A-1]
- Lease Agreement between Medical Partners, LLC (landlord) and SCS, LLC (tenant) for lease of the site [February 13, 2006, supplemental information, Appendix 4]

With the exception of the Charity Care Policy, all documents provided above are in final format. The documents demonstrate intent for the ASC to have appropriate relationships with ancillary and support services for the health care services to be provided. Additionally, the applicant intends to meet all of the necessary documentation required for the operation and management of the ASC.

While the Charity Care Policy is acceptable in concept, given that it is a draft document, any approval should be conditional upon the applicant agreeing to provide the final Charity Care Policy to the department at within 120 days prior to completion of the project. With this term, this sub-criterion would be met.

- (3) There is reasonable assurance that the project will be in conformance with applicable state licensing requirements and, if the applicant is or plans to be certified under the Medicaid or Medicare program, with the applicable conditions of participation related to those programs.

Given that both SCS and the LLC are new entities, there is no compliance history available for either. However, HMC is currently operating and the five physicians that make up the Kitsap Outpatient Surgery, LLC, and the additional physicians proposing to use the ASC are currently practicing and would have compliance history. From January 2001 to April 2006, the Department of Health's Office of Health Care Survey (OHCS), which surveys both hospitals and ASCs within Washington State, has completed four compliance surveys for HMC.¹¹ The surveys revealed minor deficiencies typical for a hospital and HMC submitted a plan of corrections and demonstrated implementation the required corrections. [source: compliance survey data provided by Office of Health Care Survey]

¹¹ Relicensure and fire/life safety surveys performed January 2001, December 2002, April 2004, and October 2005.

The Department of Health's Medical Quality Assurance Commission credentials all staff in Washington State and is used to review of the compliance history for the physicians associated with Kitsap Outpatient Surgery, LLC. Additionally, Blake Reiter, MD is identified as the medical director of the proposed ASC. A compliance history review of all five physicians reveals no recorded sanctions for all. [source: compliance history provided by Medical Quality Assurance Commission]

Given the compliance history of the hospital and the compliance history of the physicians to be associated with the ASC, there is reasonable assurance that SCS, LLC would operate the ASC in conformance with applicable state and federal licensing and certification requirements. This sub-criterion is met.

- (4) *The proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system.*

To demonstrate compliance with this sub-criterion, the applicant provided the following statements:

“The frequent and working relationship between surgeons, their clinic staff, and the staff of the surgery facility provide an assurance of continuity of care. Pre-surgical planning and post surgical follow-up is facilitated by the office and operating rooms staff work closely together on a daily basis. In the event of the need for hospital care, SCS, LLC, [has already established] a transfer agreement with Harrison Medical Center. Further, any required diagnostic work, imaging, or follow-up services outside the ASC’s scope will take place at HMC Bremerton or Silverdale campus.”

Further, SCS, LLC provided a listing of services that would be provided through the ASC and those that would be provided through the hospital. [source: Amended Application, p50]

After reviewing the information above, the department concludes that the applicant demonstrated intent for the ASC to have appropriate relationships with ancillary and support services for the health care services to be provided. Additionally, the applicant intends to meet all of the necessary documentation required for the operation and management of the ASC. This sub-criterion would be met.

- (5) *There is reasonable assurance that the services to be provided through the proposed project will be provided in a manner that ensures safe and adequate care to the public to be served and in accord with applicable federal and state laws, rules, and regulations.*

This sub-criterion is evaluated in sub-section (3) above, and based on that evaluation, the department concludes that this sub-criterion is met.

D. Cost Containment (WAC 246-310-240)

Based on the source information reviewed and subject to the terms and condition on page 4 of this evaluation, the department determines that the application is consistent with the applicable cost containment criteria in WAC 246-310-240.

(1) Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.

In the initial application, SCS, LLC considered three alternatives before submitting the application. Those alternatives include 1) do nothing; 2) develop a time-share exempt ASC; and 3) establish a joint venture with Harrison Medical Center. The applicant rejected the first two alternatives for the following reasons:

Do Nothing (or status quo):

SCS, LLC asserts that this alternative would result in each surgeon either developing a single specialty, exempt ASC for their own use or continuing to depend on HMC for any services.

Time-share exempt ASC

SCS, LLC asserts that under this alternative, operation and management of the facility would be extremely complex. The requirements for sufficient separation of activities were considered burdensome in time, staff, and money. Further, some of the partners' office practices are not located sufficiently adjacent to the proposed ASC location to meet the time-share ASC requirements. Finally, this arrangement would still not allow for non time-share physician access to the ASC, which could reduce the potential for economies of scale.

Rejection of the first two alternatives resulted in the submission of the initial application on June 24, 2005; however, the applicant continued to believe that the third option--partnering with HMC--would be a superior alternative to the initial application. During the pre-review of the initial application, discussions continued with HMC as a partner for the ASC. On December 29, 2005, SCS, LLC submitted this amended application, which includes HMC as a 30% partner. The five owning physicians and HMC agree that this partnering arrangement reduces the likelihood of a duplicative freestanding ASC being developed in the community. As a result, the applicant further asserts that approval of this project would reduce unnecessary duplication of health care services in the area. [source: Initial Application, p35; Amended Application, p52-53]

OASC's position related to the cost containment criteria is that superior alternatives are both available and practicable. Further, the alternative not considered in this application is the exploration of entering into agreements with OASC for OR time and space. [source: Olympic Ambulatory Surgery Center, public hearing documents submitted April 19, 2006, p22-23]

SCS, LLC provided responses to this issue within its rebuttal documents. Much of the information provided by SCS, LLC focused on the financial issues experienced by HealthSouth since year 2003 and HealthSouth's year 2005 failure to resyndicate OASC.¹² As a result, Kitsap County physicians are unwilling to align with the HealthSouth organization. [source: SCS, LLC May 4, 2006, rebuttal documents, pp61-62]

¹² Resyndication is when the existing properties are sold to new limited partners who can gain tax advantages that have been exhausted by the current partnership. [source: Dictionary of Finance and Investments Terms, 2nd Edition, Copyright 1987]

In the need portion of this evaluation, application of the numeric methodology resulted need for additional ORs in the planning area. Further, the department concluded that SCS, LLC demonstrated the project met the criteria within financial feasibility and structure and process of care.

In summary, the department concludes that the applicant chose the one of the best available options for the patients and the community by establishing a joint venture with the hospital. Based on the information provided above, the department concludes that this project is consistent with this sub-criterion.

(2) *In the case of a project involving construction:*

(a) *The costs, scope, and methods of construction and energy conservation are reasonable;*

As stated in the project description portion of this evaluation, this project involves construction. This sub-criterion is evaluated within the financial feasibility criterion under WAC 246-310-220(2). Based on that evaluation, the department concludes that this sub-criterion is met.

(b) *The project will not have an unreasonable impact on the costs and charges to the public of providing health services by other persons.*

This sub-criterion is also evaluated within the financial feasibility criterion under WAC 246-310-220(2). Based on that evaluation, the department concludes that this sub-criterion is met.